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Trusted Advisor

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In This Issue:

"It was never my trading that made the big money, it was always the waiting." - Jesse Livermore

Jesse Livermore was a speculator of the 20th Century who made and lost fortunes until his death in 1940. While he was far from a "value" investor, Livermore's advice reflects a tenet of successful value investing. Patience in choosing investments that have merit are far more productive than frequent, frenetic trading. Although not frozen in place during the rough quarter just past, we tried to bring a measured, careful decision making process to the sales and purchases that were made.

In financial markets that are tumbling, as they did in the first quarter of 2008, winning means "losing less than everyone else". We feel we have met this standard. Trusted Financial's unweighted average account was off about 3.5%, while our weighted average accounts declined 2.9%. This compares favorably with some major national equities markets:

Country	First Quarter Return
U.K.*	(11.7%)
France	(16.4%)
India	(19.3%)
China	(32%)
Russia	(10.5%)
U.S (DJIA)	(7.9%)
Brazil	(5.4%)

Source: The Wall Street Journal, as quoted at Fool.com, April 1 2008

While patience is an investing virtue, the quarter's activities illustrated what we believe is an attribute of our investment approach: we are willing to take a loss, and admit we were "wrong" about an investment, as we did when we lowered exposure to the Third Avenue Value fund and sold off VCA Antech and HRPT properties, the latter two at a loss. We were opportunistic in our purchases too. For a number of accounts, we took a position in Wells Fargo Corporation. We felt it was undervalued, and a good long term holding, paying a healthy dividend. The stock took off within a few trading sessions. Then, unexpectedly, reports began to surface that two "monoline" bond

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insurers, AMBAC and MGIC, were in danger of losing their long held "AAA" credit ratings. These two are dominant backers of insured municipal bonds, widely held by banks. Were their credit ratings to fall, so would the ratings of bonds they had insured. This in turn would have meant large accounting write-offs for the banks, on top of those already suffered due to the "sub prime" mortgage crisis. We decided to take a quick 14% profit. We're gratified to note that ten weeks after we closed this profitable position, the stock is trading well below our selling point.[1]

Fixed Income Sector Presented Opportunities

High anxiety regarding future prospects for some prominent financial companies presented attractive opportunities to purchase their bonds. We were able to position in short-to-intermediate term maturities at discounted prices, with high yields to maturity. We have taken small positions in investment grade bonds issued by certain financial institutions such as Countrywide, Washington Mutual, CIT group and HSBC holdings.

Although the firms listed have seen their stock prices plummet and their credit ratings downgraded, they remain rated as "investment grade", not "junk". And yet, for a time, the market was pricing these bonds at levels that implied imminent bankruptcy. It was and is our judgment that even if bankruptcy ensues, bond holders, as owners of *senior* securities, will be made whole[1]. All four companies hold valuable client relationships, branch locations or other unique assets that would be attractive to an acquirer or investor. So far, two of these companies, Countrywide and Washington Mutual, have already attracted strong institutional backing and have been pulled back from the brink, so to speak. We continue to feel these investments represent reasonable business risks.

Winning Positions

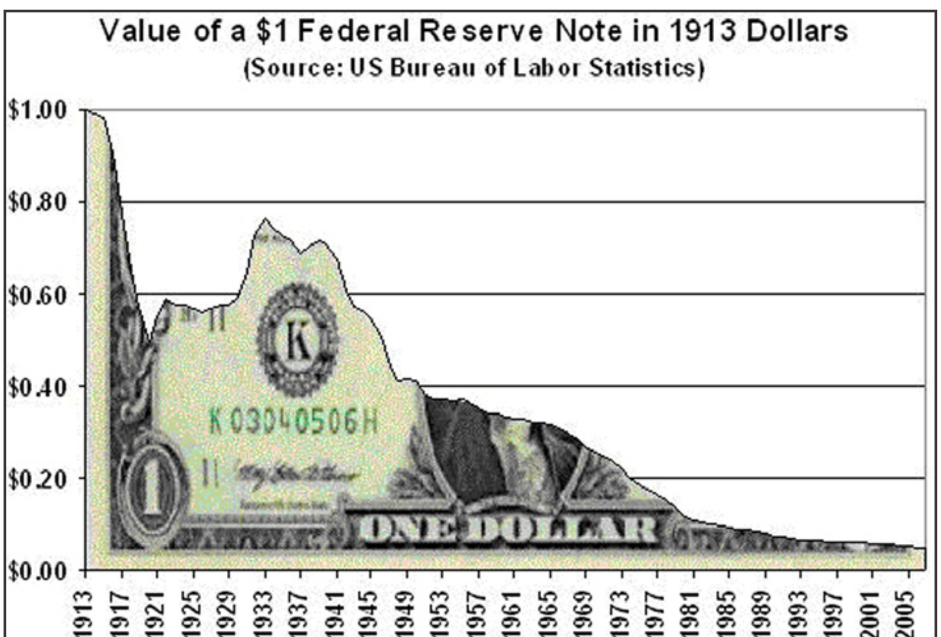
Besides the successful Wells Fargo trade, a number of our client holdings did well. A widely held international bond fund was up about 6% in the quarter alone. It pays a healthy dividend. Of course, this is a bittersweet story for all of us: the success of foreign currency bonds is a result of a plummeting of the US dollar on world currency markets. Sadly, we see no reason for this process to reverse until the US Federal Reserve bank feels it is safe to stop lowering short term interest rates, a move forced upon them by a liquidity crisis and recession in the United States. The weakening dollar must be given credit, too, for a modest 2% gain in a precious metals mutual fund held in most client portfolios. Surprisingly, energy producers and transporters gave mixed results, although as a group they held up better than the market averages. Devon Energy, a natural gas producer, repeatedly reached new highs and was up over 10% for the quarter. As this newsletter is written, all natural gas producing companies are soaring. Energy pipelines, representing 7-10% of most client portfolios did not rise as one would have expected, given a cold winter, but the sell off was relatively mild, and we were also aided by their healthy dividend payouts, at over 6% annual rate. It appears some investors worried about the availability of credit to these capital intensive companies and about the possibility that shipping volumes may decline in a recession. Given the large dividends (over 6%) paid by the pipelines, we expect to hold on, and we get paid for waiting.

Trusted Financial's Seven Year Track Record

I am proud to share with current and prospective clients our performance history, which just hit the seven year milestone. We measure our historical performance from March 31, 2001. This period includes good times and bad, encompassing the "tech wreck", the post-9/11 bear market and some pretty good years as well. **Over this time period, the average annual time weighted return, has been 9.89% per year. This is net to clients after our fees and unaffiliated brokerage firm commissions.**[3] We've also achieved this record, which beats most domestic stock indexes, using a balanced approach that diversifies client holdings to produce reduced portfolio volatility. Our long term performance indicates a portfolio volatility rate at less than one half that of the US stock market, as measured by the Standard & Poors 500.

The Coming Tax Tidal Wave or the Coming Inflationary Flood

Comptroller of Currency, David Walker, who just resigned, estimated recently that Washington has promised $53 trillion in Social Security and Medicare benefits without funding them. In real dollars that means every American - this means you - owns a $175,000 share of the federal debt. It's as if you have a second mortgage - for a home you don't own. Senator John McCain, who admits he is not a financial expert, has already painted himself into a "no new taxes" corner as did predecessor George H. W. Bush 20 years ago. Bush was forced by Congress to relent - he agreed to phase-out many deductions for "wealthy" people as a back door way to raise revenue without losing face. Of the two Democratic presidential candidates, Senator Hillary Clinton is trying to say as little as possible about what she will do about solving the nation's soaring budget deficit while Senator Barack Obama has probably gone further than any of the candidates to reveal his plan: raise the top tax rates, raise the capital gains tax rate, and tax all earnings for Social Security purposes. No one is seriously talking about controlled spending and Democrats, now the majority in Congress, immediately broke their early 2007 promise of "pay-as-you-go" budgeting.



Source: Financial Sense Newsletter

There are only three ways this situation will resolve itself, at least at the Federal level:

1. Taxes will be raised.
2. Promised benefits for Medicare and Social Security will be cut or delayed.
3. The government will seek to borrow the money needed to meet its promises, hoping to pay years later in depreciated dollars. This is also known as "Inflation".

Since none of the current crop of Presidential candidates appears ready to provide leadership, and Congress is unlikely to vote for sufficient tax increases or spending cuts to save the day, that leaves inflationary spending as a near certainty. This is the same route taken by third world dictatorships and the Roman Empire in its declining years. A devalued currency allows politicians to meet their promises in nominal terms, while paying off in currency that buys far less than when those promises were made. The inflation rate was up over 4% in the year ended February 2008. Medical costs are rising at twice that pace. As we have noted in recent years, inflation is back and it is accelerating. Think about all those one dollar bills puffing up your wallet. Think how little one dollar buys. Notice how we spend $20's as frequently as we used to spend $5's?

We have reluctantly come to the view that we must make a major shift in our thinking with regard to the underlying economic environment. We have come to believe that we are in a secular (long term) trend of rising inflation and loss of purchasing power. In such an environment, one of the very worst places to invest money for the long term is in low interest bearing US dollar investments like money funds, certificates of deposit or Treasury bonds. Sure, they are very appropriate places to "park" money that will be needed soon and they don't fluctuate like the stock market, but unless you are earning about 5% after taxes on your "safe" money, inflation is silently stealing your net worth away from you!

How Do You Protect Yourself Against Inflation?

Inflation is not bad for everyone or for every business. Once you accept it as a feature of the economic landscape, your investment philosophy must incorporate its effects. Generally, businesses that rely on raw materials or commodity inputs in order to produce products will see their margins squeezed, because they may not be able to raise prices quickly enough to offset their costs. An extreme example of this is the airline industry, which has seen numerous bankruptcies driven by soaring costs for jet fuel coupled with fare competition. For food producers, companies like Kellogg's, ConAgra and Kraft, the process of shrinking margins may be slower and more subtle. These packaged food companies must compete for sales to a stressed US consumer, so they may be unable to raise prices sufficiently to keep up with the rising costs of raw materials. The share price for Starbucks, long a charging bull, has been tumbling for 15 months, as many of their customers say "no" to $3.50 Lattes. These types of companies would not be my first choices for investment. On the other hand, companies that own natural resources would likely be a good place to find businesses that benefit from inflation. Think of energy production and mining. Real estate is potentially a great investment but it appears prices for residential property have been so inflated that it may be a long time before prices can even stabilize, let alone rise. Certain specialized types of real estate may have potential, however. Companies that enjoy "cost plus" pricing, defense contractors and infrastructure builders, may hold certain appeal as they are able to pass their rising costs onto their government customers.

A good investment advisor can help you insulate your net worth from the vagaries of inflation. Any idea who we would suggest you contact?!

Footnotes:

1. In a corporate liquidation, assets are sold off and stake holders paid off in the following order: IRS and government claimants, senior bond holder, junior bond holders, preferred stock holders and lastly, common stock holders

2. Bank of America announced the acquisition of Countrywide and Washington Mutual received a $7BB capital infusion from private investors.

3. Our raw numbers are available for inspection. The data is produced using Portfolio Center™ software, which incorporates reporting standards recommended by the CFA Institute.